Fried Frank International Trade and Investment *Alert*™

United Kingdom Passes New National Security Law Requiring Mandatory Filings for Investments of More Than 25% in 17 Industry Sectors

Summary

On 29 April 2021, the UK adopted the National Security Investment Act 2021 (the "NSI Act" available here). The NSI Act introduces a mandatory, suspensory, regime on national security grounds for the first time, in 17 industry sectors. The NSI Act signals a radical shift in the UK's approach, replacing the existing discretionary public interest review system covering a few key sectors. The new screening process will no longer be administered by the UK's Competition and Markets Authority ("CMA") but by the UK Government's Department of Business, Energy and Industrial Strategy ("BEIS") instead.

Key features of the new NSI Act are: (i) the requirement for mandatory filings of transactions (by acquirers of any nationality) resulting in the acquisition of more than 25%[1], 50% or hitting 75% shareholding/voting rights in key sectors that the Government considers most sensitive (listed below). Transactions caught under the mandatory regime cannot close until approval is received, and the penalties for breach are potentially severe, including imprisonment; (ii) the Government is also granted broad call-in powers, which allow it to review mergers up to 5 years after completion (or up to 6 months in cases where the Government was made aware of the transaction). This call-in power applies across all industries, and can be triggered by the mere acquisition of "material influence", a nebulous concept taken from UK competition rules (that as a rule of thumb covers acquisitions of 15% or more).[2]

The new regime will come into effect only once secondary legislation has been enacted (which amongst other points will define the sectors to which the mandatory regime will apply). This is not expected to happen until Q4 2021. As such while companies have been put on notice, no mandatory filings will be

1 The main change from the draft bill to enactment of the NSI Act is the removal of an even lower 15% mandatory notification threshold.

2 "Material influence" is not defined in the NSI Act. When it introduced the NSI draft bill, the Government noted that it intends to interpret this concept in line with the UK's merger control regime, administered by the CMA. Recent CMA guidance from December 2020, suggests the concept could cover any shareholding level, even below 15%, where other factors (such as board representation, veto rights, voting practices, or other contractual arrangements) are present.

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required until the end of the year. However, the new regime will have retroactive effect, and any merger that had not closed by 12 November 2020 will be potentially reviewable.

Changes from the current to the new regime

An overview of the current regime:

- Under the current law, no mandatory filing is required. Instead, the Government can choose to intervene on the following grounds: (i) national security, (ii) media plurality, (iii) financial stability, and (iv) capability to combat and to mitigate the effects of public health emergencies.

- The general intervention thresholds are that the target (i) either generates more than £70m revenues in the UK; or (ii) that the parties have a 25% share of the supply of goods/services (requiring an overlap resulting from the merger) in the UK,[3] but in certain sensitive sectors lower thresholds apply. These are (i) military or dual-use goods subject to export control, (ii) computer processing units, (iii) quantum technology, (iv) artificial intelligence, (v) cryptographic authentication technology, and (vi) advanced materials, where the thresholds for intervention are: that the target generated more than £1m in revenues in the UK or a 25% share of supply (with no requirement for an overlap).[4]

- The look back period for the Government to review transactions is limited to 4 months following completion or when the facts of the transaction are made public/the CMA is made aware, whichever is the later.

To date, enforcement has been limited, with only 14 cases called-in for review under national security grounds since the regime's inception in 2003. Of these, none have resulted in a prohibition.[5]

Key provisions of the new regime under the NSI Act:

By contrast, a significant uptick in merger reviews is expected under the new mandatory regime. The Government expects to review up to 1830 national security mergers a year, of which approximately 10 a year are expected to require remedies. As to the requirements of the new regime, very little has changed since the draft bill was introduced last November (see our note here), and the key provisions are as follows:

- Low jurisdictional thresholds: investors acquiring shareholdings (or equivalent voting rights[6]) of above 25%, 50%, or hitting 75% or more, in designated sensitive sectors ("Specified Sectors"), will be required to make mandatory notifications. However, asset deals will not be covered.

- Limited to specific industries: The Specified Sectors[7] expected to be covered are advanced materials, advanced robotics, artificial intelligence, civil nuclear, communications, computing

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3 Note, the Government can also intervene in national security transactions under the "special public interest regime" which allows intervention where the thresholds are not met, but the target is a government contractor who holds or receive confidential defence-related information.

4 See Fried Frank prior publication, "UK Expands Merger Review Powers for National Security Transactions" here.

5 Two of these cases are still ongoing, being called-in in 2021. These are Nvidia's proposed acquisition of Arm, and Advanced Micro Devices, Inc's proposed acquisition of Xilinx, Inc. Both cases concern acquisitions by U.S. buyers, of chip manufacturers.

6 The NSI Act also captures the acquisition of voting rights that enable or prevent the passage of any class of resolution governing the affairs of the entity.

7 BEIS published its proposed definitions in March 2021 (here). These definitions are not yet binding.

hardware, critical suppliers to Government, critical suppliers to the emergency services, cryptographic authentication, data infrastructure, defense, energy, military and dual-use, quantum technologies, satellite and space technologies, synthetic biology and transport. The Government consulted widely on the scope of the sectors to be included, some of which have been narrowed since the draft law was introduced, but the exact definitions will not be known until publication towards the end of the year.

- Foreign-to-foreign transactions with limited UK nexus are caught: there is no minimum turnover or share of supply threshold, or a requirement for a target to have a UK subsidiary or assets, for the regime to apply. The NSI Act merely requires that a target "carry on activities in the UK" or "supply goods or services to persons in the UK", which constitutes a sufficient UK nexus.[8]

- Identity of the buyer is not relevant: the new regime is focused on the activities of the target and its nexus to the UK. All potential buyers, including from "friendly" and "hostile" states alike, and even those from the UK, will need to file if the thresholds are met.

- The regime is suspensory and penalties for breach are potentially severe: completion is prohibited until clearance has been received. Any transaction that is subject to a mandatory notification obligation but is completed without approval is void. Furthermore, there are considerable civil and criminal penalties for non-compliance, including fines of up to 5% of worldwide turnover or £10 million; and imprisonment of up to 5 years.

- Lengthy time period for review: after a mandatory notification is accepted, the Government will have 30 working days to decide whether or not to initiate a full review (termed "calling-in" in the NSI Act) of the transaction. If the transaction is called-in, then the Government will have another 30 working days (the "assessment period") to review the case and decide on remedies, if any. The assessment period can be extended by another 45 working days and, following that, a further amount of time as agreed to between the Government and the acquirer in the transaction.

The NSI Act also introduces discretionary call-in powers. Those are very similar to the mandatory regime, save that:

- A 5-year look-back and retroactive effect: for transactions outside of the Specified Sectors, the Government can still review of its own initiative non-notified investments for up to 5 years post-completion (or 6 months if the Government is "made aware" of the investment). The review period applies from 12 November 2020, so any deal that had not closed by then is potentially reviewable.[9]

- Broad trigger events: the same trigger events apply as for the mandatory regime, but in addition included (1) acquisitions which enable "material influence",[10] as well as (2) asset sales. Furthermore the call-in powers can be used in any industry sector so long as a trigger event has occurred and there is a "risk to national security".[11]

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8 NSI Act, section 7.

9 The 5 year and 6 month review period will only commence when the NSI Act comes fully into force. Until then transacting parties exist in somewhat of a limbo state, with the countdown clock not yet commenced, even if they make the "Secretary of State" (i.e. BEIS) aware before the NSI Act comes into effect.

10 See footnote 2 above.

11 Regrettably the Government resisted an amendment to the draft bill that would have narrowed down the concept of "risk to national security" to a clear cut specific definition.

- Voluntary notifications: the parties can also submit a voluntary notification for review. This is most likely to occur in sales of sensitive assets (which would not be caught by the mandatory regime). The timings for voluntary notifications are the same as for mandatory notifications.

Administration of the NSI Act

The NSI Act's key provisions will only come into effect later in the year. For example, the mandatory notification regime first requires the Government to make regulations incorporating the definitions of the Specified Sectors, and so in the meantime, the current discretionary regime continues to apply.[12] Once the new regime comes into effect, review of transactions will be undertaken by the Investment Security Unit ("ISU"), a new unit within BEIS. The ISU will become the transacting parties' point of contact for deals that fall within the scope of the regime (alongside any other regulatory clearance processes, such as merger filings with the CMA).

Conclusion

With the NSI Act the UK has for the first time adopted an expansive mandatory and suspensory regime for screening investments on national security grounds. When it comes into effect, which is expected to be at the end of the year, the NSI Act will result in wholesale changes to the UK regulatory framework. The existing discretionary regime will be replaced with (i) a requirement for mandatory filings of transactions resulting in the acquisition of more than 25% or 50% or hitting 75% of the shareholding/ voting rights in the 17 industry sectors that the Government considers most sensitive. The rules apply regardless of the home country of the acquirer, transactions caught under the mandatory regime cannot close until approval is received, and the penalties for breach are potentially severe, including imprisonment; (ii) the Government is also granted broad call-in powers, which allow it to review mergers (including acquisitions of material influence) in any sectors up to 5 years after their completion (or a 6 months look-back period where the Government is made aware of the transaction).

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[12] For example, on 11 May 2021, the CMA notified AMD's acquisition of Xilinx to the Government under the old regime, which will now consider whether the case warrants an investigation under its discretionary powers on national security grounds, alongside the CMA's ongoing competition review.

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